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IN THE
Supreme Court of the United States

OCTOBER TERM, 1939

NO. **105-1** 110

LEE H. MARSHALL HEIRS, ET AL., FIDELITY
TRUST COMPANY, Trustee, Petitioners,

v.

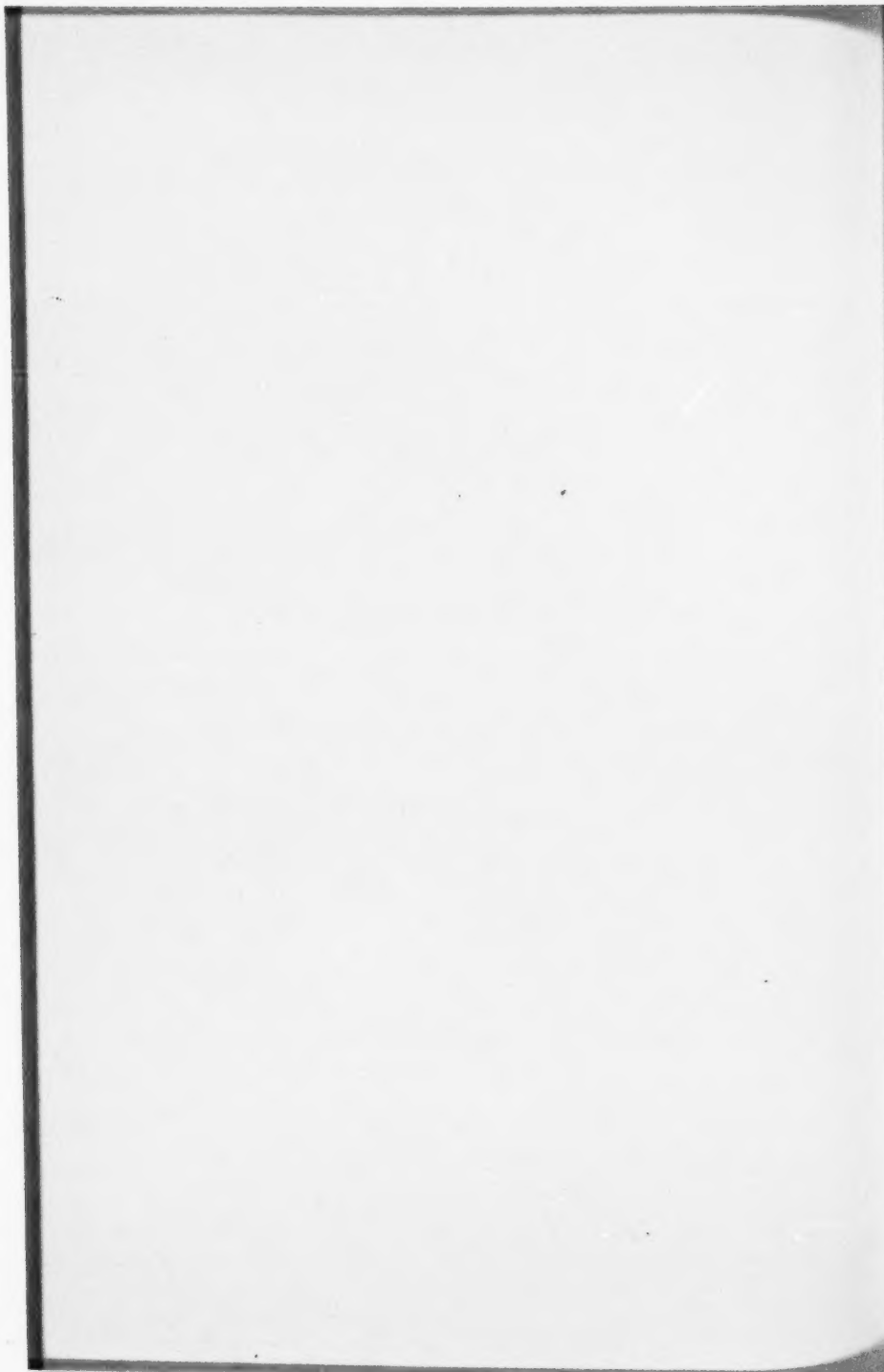
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

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Pittsburgh, Pa.



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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

*To the Honorable Chief Justice and Associate Justices
of the Supreme Court of the United States:*

Fidelity Trust Company respectfully prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit, filed in the above case, affirming, by a divided opinion, a decision of the Board of Tax Appeals in which said Board, also by divided opinion, sustained a determination made by the Commissioner of Internal Revenue that additional income taxes and excess profits taxes are due from the petitioner for the year 1934, on the ground that the trust of which the petitioner was trustee was an "association" taxable as a corporation.

Summary Statement of the Matter Involved.

The only question at issue is whether the trust, of which the petitioner was trustee, was an "association" within the terms of Section 801 (a) (2) of the Revenue

Act of 1934 (c. 277, 48 Stat. 680), which provides that the term "corporation" as used in said Act includes "associations."

The trust estate here in question consisted of a single piece of land, forming part of a larger tract upon all of which the lessee of the tract had erected a business building. The lease had been entered into several years before the trust was created, and the trust was co-terminous with the lease.

The trust was created by deed of trust (R. 81) dated November 30, 1925, executed by Lee H. Marshall, Vardy Marshall Morris, Margaret Marshall Hamilton, and Elizabeth Marshall Rowe (hereinafter referred to as the "Marshall heirs"), their respective spouses joining. Fidelity Trust Company (then called Fidelity Title and Trust Company), a trust company doing business in the City of Pittsburgh, Pennsylvania, was named as trustee. The grantors and "their heirs, executors, administrators and assigns" were named beneficiaries.

By virtue of the deed the Marshall heirs conveyed to the trustee a certain tract of land in the City of Pittsburgh, of which they were then the owners, subject to a certain mortgage and to leases, originally entered into in 1917 and, in 1924, extended to April 30, 1968, under which the land was leased to a corporation (in which the Marshall heirs had no interest).

As appears from a plot plan (R. 91), the Marshall land constitutes only a portion of a larger tract, bounded by Diamond Street, Smithfield Street and Fifth Avenue, which is owned by various owners. By virtually identical long term leases (R. 93) the owners of the several portions of the tract leased the land to a tenant who erected on the whole tract a single building, known as the Frank & Seder Department Store. None of the owners of the various parcels of the large tract has any

interest in the building, except only whatever interest he may, as a result of his ownership of the land, have in that portion of the building which stands upon his particular portion of the land; none has any interest or voice in the operation of the building; and none has an interest in the ownership or in the management of the department store. (R. 19, 40, 53)

The lease provides that the lessee shall erect upon the entire tract (of which the Marshall land is part) a steel and fireproof building; that the lessee shall pay the taxes and water rent and all charges for electricity, etc.; and that the lessee shall keep the premises insured, shall make all repairs without abatement of rent, shall remove all debris from the premises, etc. (R. 19, 93)

The deed of trust provided that the trustee should hold title to the premises, collect the rents due under the lease and pay the net income to the beneficiaries. The deed was revocable,¹ and provided further that the trust should terminate upon the death of the last survivor of the grantors and, in any event, on April 30, 1968, the date upon which the lease expired.

The trustee's only function was to receive the rentals due with respect to the Marshall land and, after paying interest and amortization upon the mortgage and deducting the trustee's compensation, to pay the net balance over to the beneficiaries in quarterly installments. The trustee had no share in the management of the department store (R. 53) and, since the lease is a net lease, it had no responsibility for the payment of taxes, insurance, or other charges (R. 53, 62). It did not even have responsibility for seeing to the maintenance of insurance upon the property, since another

¹ The trust was in fact revoked by action of the beneficiaries on August 7, 1936. (R. 51)

company was trustee of the various insurance policies for the benefit of all of the owners. (R. 59) In recognition of these very limited functions and responsibilities, the trustee served for a compensation of \$800 per year, an amount considerably less than would be a fee based upon the trustee's regular rates for the administration of trusts. (R. 53)

The trustee handled the estate in the ordinary course of its trust business, in exactly the same manner as it handled any one of hundreds of other trust estates. (R. 53, 61-62)

Aside from the collection of rent and the distribution thereof as above outlined, the only other action of the trustee was the negotiation of an agreement by which the rent due under the lease was reduced after the tenant had gone into bankruptcy and had been reorganized. (R. 62-63, 67) In its opinion, (R. 147, 148) the court below states that the trustee also negotiated a new mortgage upon the premises in 1927. This is incorrect. The new mortgage was negotiated by the Marshall heirs themselves. (R. 50, 51)

The deed provided that the trustee should not be liable beyond the assets in its hands; but it contained no express limitation of liability on the part of the beneficiaries. It contained no provision for the issue of certificates of interest.

The Commissioner of Internal Revenue was of the opinion that the trust was an "association" taxable as a corporation, and he made an assessment against the petitioner of income taxes and excess profits taxes for the year 1934², calculated on that basis. (R. 9)

² A similar assessment was made with respect to the years 1932 and 1933, but the court below correctly held

The determination of the Commissioner was sustained by the Board of Tax Appeals, two members dissenting. (R. 15) On appeal to the Circuit Court of Appeals, the decision of the Board of Tax Appeals was affirmed, Maris J. dissenting. (R. 145, 150)

Reasons Relied on for the Allowance of the Writ.

1. The decision of the court below is a decision upon an important question of general law. It is believed that the majority opinion (Biggs and Clark, JJ.) reaches a result which is unsound and untenable. If the decision is to stand, it will completely alter what has been supposed to be the law on the subject. As was said by Judge Maris in his dissenting opinion,

"As I see it, the trust was in every respect a typically traditional one 'to hold and conserve particular property, with incidental powers,' as Chief Justice Hughes put it in *Morrissey v. Commissioner*, *supra*, p. 357. * * *

"The majority of the court point to certain characteristics which in their view stamp the trust as a business one, but all of these are present in the ordinary type of traditional trust. Indeed I find it hard to conceive of a type of trust which would be more typically traditional and less of a business trust than this. *It seems to me that under the decision of the court in this case every trust in which one or more trustees hold and administer real property for two or more beneficiaries must be held to*

that the assessment for those years was barred by limitation, in accordance with the principles set forth in the decision of this Court in *Germantown Trust Company v. Commissioner*, 309 U. S. . . . , 84 L. Ed. These years are, therefore, not in issue at the present time.

*be a taxable association and that the 'traditional trust' of which the Chief Justice spoke does not exist. I cannot believe that the Revenue Acts intended any such result."*³ (R. 151-152)

2. The decision of the Circuit Court of Appeals runs directly counter to the decisions of this Court in *Morrissey v. Commissioner*, 296 U. S. 344, 80 L. Ed. 263 (1935) and *A. A. Lewis & Co. v. Commissioner*, 301 U. S. 385, 81 L. Ed. 1174 (1936), in which this Court held that trusts, the object of which is "to hold and to conserve particular property, with incidental powers," are not to be taxed as corporations.

3. The decision of the court below is in direct conflict with the decisions of the Circuit Courts of Appeals for the First and Seventh Circuits in *Lansdowne Realty Trust v. Commissioner*, 50 F. (2d) 56 (C. C. A. 1, 1931) and *Myers v. Commissioner*, 89 F. (2d) 86 (C. C. A. 7, 1937).

4. This Court endeavored, in the case of *Morrissey v. Commissioner*, *supra*, and in the related cases, to lay down guiding rules of decision with respect to the question what trusts are to be considered as "associations" taxable as corporations. Unfortunately, despite its great practical importance, the question still remains unsettled, as is evidenced not only by the fact that the decision of the court below and the decision of the Board of Tax Appeals were arrived at by divided tribunals, but also the fact that the courts as well as the Board of Tax Appeals are still uncertain as to the guiding principles to be followed. The subject should, therefore, be further clarified by this Court.

³ The italics have been supplied.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Third Circuit, commanding that Court to certify and send to this Court, for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in this case; that the judgment of said Court may be reversed; and that your petitioner may have such other and further relief in the premises as to your Honorable Court may seem meet and just.

And your petitioner will ever pray.

CHARLES DENBY,
Attorney for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

I.

Opinions Below.

The opinion of the Circuit Court of Appeals has not yet been reported. The majority opinion and the dissenting opinion appear in the Record. (R. 145, 150)

The opinion of the Board of Tax Appeals is reported in 39 B. T. A. 101. The majority opinion also appears at page 15 of the Record. The dissenting opinion appears at page 32 of the Record.

II.

Jurisdiction.

This Court has jurisdiction under Section 240 (a) of the Judicial Code (28 U. S. C. §347 (a)), since this is a cause in which a final decree of a Circuit Court of Appeals has been entered.

The decree of the Circuit Court of Appeals was entered April 26, 1940.

III.

Statement of the Case.

A statement of the essential facts of the case is included in the petition. The following additional facts may be noted.

The Marshall land had been in the Marshall family since 1862; but, due to successive deaths and conveyances, there were, by 1917, various outstanding undivided interests. At that time George V. Marshall, father of the present beneficiaries, made plans to gather the various interests into one ownership in order that the land, together with adjoining land owned by others,

might be leased to a department store. Leases were accordingly entered into by the various owners in 1917, leasing the property to April 30, 1938. (R. 19-21, 41-42, 93)

On May 6, 1918, George V. Marshall died, leaving his interest in the property to Emma L. Marshall, his wife. She caused a corporation, the Marshall Land Company, to be incorporated in 1920 to facilitate the acquisition of remaining outstanding undivided interests in the Marshall land, and these were accordingly acquired by the corporation between 1920 and 1924. Emma L. Marshall later divided her stock in the Marshall Land Company among her four children, the beneficiaries under the present trust. (R. 22, 43-45)

In April, 1924, the department store, desiring to make extensions to the building, entered into an agreement with the Marshall Land Company and with owners of other portions of the tract, whereby the various leases were extended from April 30, 1938, to April 30, 1968. (R. 22, 113)

After the acquisition of clear title to the Marshall land and the extension of the lease to 1968, no further activity of any kind became necessary on the part of the owners, other than the collection of rent. It was accordingly determined to dissolve the corporation. This was accordingly done, and on November 30, 1925, the corporation conveyed the land, which was substantially its only asset, to its four shareholders as tenants in common. They immediately thereafter conveyed the land to Fidelity Trust Company under the deed of trust here in question. (R. 23)

IV.

Specification of Errors Intended to Be Urged.

The Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals, to the effect that the trust here in question was an "association" taxable as a corporation in the year 1934.

V.

ARGUMENT.**1. The Decision of the Court Below Conflicts With Decisions of This Court.**

Section 801 (a) (2) of the Revenue Act of 1934 provides as follows:

"The term 'corporation' includes associations, joint stock companies, and insurance companies."

The word "associations" has received no statutory definition, and its meaning has been left to judicial interpretation. Due to the conflict of decisions on the question of what trusts may be classed as "associations" and taxed as corporations, the Supreme Court a few years ago granted certiorari in four cases involving various sets of facts, and in deciding them reviewed and clarified the law on the subject. These cases are the leading case of *Morrissey v. Commissioner of Internal Revenue*, 296 U. S. 344, 80 L. Ed. 263 (1935); and the related cases of *Swanson v. Commissioner of Internal Revenue*, 296 U. S. 362, 80 L. Ed. 273 (1935); *Helvering v. Combs*, 296 U. S. 365, 80 L. Ed. 275 (1935); and *Helvering v. Coleman-Gilbert Associates*, 296 U. S. 369, 80 L. Ed. 278 (1935).

Any consideration of the law applicable to the present case must, therefore, start with a consideration of the decision in the *Morrissey* case, in which was written the opinion which governs all four of these cases.

In the *Morrissey* case this Court pointed out clearly that the test by which is to be determined whether a trust is an "association" does not lie in any of the formal features of the enterprise, but that the only test is whether the enterprise is in fact one *for the conduct of business*. As the Court said,

" 'Association' implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, an enterprise for the transaction of business. *This is not the characteristic of an ordinary trust—whether created by will, deed, or declaration—by which particular property is conveyed to a trustee or is to be held by the settlor, on specified trusts, for the benefit of named or described persons.* Such beneficiaries do not ordinarily, and as mere cestuis que trust, plan a common effort or enter into a combination for the conduct of a business enterprise. Undoubtedly the terms of an association may make the taking or acquiring of shares or interest sufficient to constitute participation, and may leave the management, or even control of the enterprise, to designated persons. But the nature and purpose of the cooperative undertaking will differentiate it from an ordinary trust. *In what are called 'business trusts' the object is not to hold and conserve particular property, with incidental powers, as in the traditional type of trusts, but to provide a medium for the conduct of a business and sharing its gains.* Thus a trust may be created as a convenient method by which persons become associated for dealings in

real estate, the development of tracts of land, the construction of improvements, and the purchase, management and sale of properties; or for dealings in securities or other personal property; or for the production, or manufacture, and sale of commodities; or for commerce, or other sorts of business; where those who become beneficially interested, either by joining in the plan at the outset, or by later participation according to the terms of the arrangement, seek to share the advantages of a union of their interests in the common enterprise."⁴

The Court then analyzed what are "the salient features of a trust—when created and maintained as a medium for the carrying on of a business enterprise and sharing its gains—which may be regarded as making it analogous to a corporation organization?" These features the Court found to be continuity of ownership; centralized management, with trustees who act "in much the same manner as directors"; security from the termination or interruption of business by the death of the owner of a beneficial interest; ready transferability of beneficial interests; and the "limitation of the personal liability of participants to the property embarked in the undertaking." The Court hastened to add, however,

"It is no answer to say that these advantages flow from the very nature of trusts. For the question has arisen because of the use and adaptation of the trust mechanism. The suggestion ignores the postulate that *we are considering those trusts which have the distinctive feature of being created to enable the participants to carry on a business and divide the gains which accrue from their common undertaking*,—trusts that thus satisfy the primary

⁴ 296 U. S. at pp. 356-357, 80 L. Ed. at pp. 270-271. The italics have been supplied.

conception of association and have the attributes to which we have referred, distinguishing them from partnerships. *In such a case*, we think that these attributes make the trust sufficiently analogous to corporate organization to justify the conclusion that Congress intended that the income of the enterprise should be taxed in the same manner as that of corporations.”⁵

It is thus clear that the features of limitation of personal liability, ready transferability of beneficial interests, etc., are not the real tests, because these features admittedly “flow from the very nature of trusts”; but that the only decisive test is whether the trust in question has the “distinctive feature” that its associates have embarked upon a *business enterprise*, and have not adopted the trust device merely in order to “hold and conserve particular property.” The words “business” and “enterprise” imply activity, initiative, risk; they imply an effort to win a profit through active and skillful management. The mere holding of property and the collection and distribution of the rents therefrom have none of these implications.

As the Supreme Court said in the passages above quoted, a trust will be considered an “association” if it is engaged in “*dealings* in real estate,” or “the *development* of tracts of land,” as distinguished from merely holding a particular property and collecting the income therefrom; if it engages in “the *construction* of improvements, and the *purchase, management* and *sale* of properties”; if it engages in “production,” “manufacture,” “commerce”—if, in short, it is engaged in an “*enterprise*.”

⁵ 296 U. S. at pp. 359-360, 80 L. Ed. at p. 272. The italics have been supplied.

A year after its decision in the *Morrissey* and the related cases, this Court again had occasion to define what is an "ordinary trust," taxable as such, and not taxable as an association. In *A. A. Lewis & Co. v. Commissioner*, 301 U. S. 385, 81 L. Ed. 1174 (1936), a tract of land was conveyed to a trust company, in trust for the grantor and another. The object of the grantor was to divide and sell the land, and the trustee was given power to execute conveyances of title, as directed by the other beneficiary. The trustee was to collect payments received and distribute them to the beneficiaries, but was to have nothing to do with the sales of the lots or with negotiations leading up to them. This Court said,

"The arrangement here answers the foregoing description of an ordinary trust—that is, it was created in virtue of a declaration by which *a designated piece of real property was conveyed to the trustee on specified trusts, for the benefit of definitely named persons*, one of whom was the grantor of the land and the other an agent of the grantor for the sole purpose of subdividing and selling the land. * * *"⁶

The essential feature of the corporate device is that it permits taking the risks involved in engaging in a business enterprise without exposing the entire fortune of the shareholder to possible loss. It is socially desirable that investors be encouraged to take risks in the development of new enterprises, by permitting them to limit their risk. It is this privilege which, on the other hand, justifies the taxation of the income of corporations at a higher rate, and the taxation at the same rate of an enterprise which, while differing in form, accom-

⁶ 301 U. S. at pp. 388-389, 81 L. Ed. at p. 1176. The italics have been supplied.

plishes the same *purposes*. But where the trust is of the traditional type and is engaged merely in holding property, in preserving the corpus of the trust, and in collecting and distributing the income therefrom, its activities have no economic similarity to engaging in a business enterprise. Regardless of similarities in *form*, its *purpose* is wholly different; and there is no basis for taxing a trust of this character upon any analogy to a corporation.

By every standard laid down in the *Morrissey* and *A. A. Lewis & Co.* cases, the present trust is a strict trust:

a. *The Trust Was Limited to a Particular Property.*

Reference to the deed of trust (R. 81) indicates that the deed embodied a conveyance of a particular tract, and that the conveyance was upon trusts, all of which had relation *to that particular property*. The trustee was to hold "the said premises"; to lease "the said premises"; to oversee the payment of taxes, insurance, etc., "upon the said premises"; to sell the whole or any part of "the said premises," etc. This is not a trust to engage in the *business* of owning, developing and operating real estate generally as was the case in the *Morrissey* case, the *Coleman-Gilbert* case, or in other cases which follow them. The trustee had no power to acquire any other property of any kind. There *could be* no "*dealing*" in property.

b. *The Trust Was of Limited Duration.*

When the property was conveyed to the trustee it was already subject to leases extending to April 30, 1968. It is to be noted that, although the trust might

be terminated sooner at the will of the beneficiaries or by the death of all of them, the trust was at all events limited in duration to that date. (R. 84). This is different from the usual business trust which is generally set up to continue in existence for the maximum period permissible under statutes against perpetuities.

c. *The Trust Had a Definite Body of Beneficiaries.*

While admittedly the number of beneficiaries is not controlling in determining whether a trust is an "association," it may be noted that the present trust agreement manifestly does not contemplate a changing body of beneficiaries, analogous to the changing body of stockholders of a corporation. Not only is there no provision for the issuance of certificates of interest, but there is no specific provision in the deed of trust for the assignment of interests of beneficiaries.⁷

d. *The Trust Was Not Operated as a Separate Entity.*

The record will be searched in vain for anything to indicate that the trustee here acted "in much the same manner as directors." On the contrary, this property was administered by the trust company in the usual course of its business, just like all other properties which

⁷ In fact, the question of assignment is referred to, quite indirectly, in only two places in the deed of trust, once at the point at which the beneficiaries "reserve unto themselves and their heirs and assigns, the right to revoke this instrument at any time" (R. 84) and again where it is provided that the trustee shall hold the property "to pay to the parties of the first part, their heirs, executors, administrators, and assigns, as their interest may appear, the net income from the property." (R. 85)

it held in trust. (R. 53, 61-62) The trust had no letter-heads (R. 52, 62), no contact with the public (R. 52), no certificates of interest (R. 48, 52), and no employees (R. 62). The trustee held no stated or formal meetings with the beneficiaries. (R. 48, 52) The trust was administered exactly like "any one of a hundred decedents' estates under which the Fidelity Trust Company is trustee." (R. 53) The rental was received from the tenant by the real estate department of the trust company, just as it was for other trust estates. (R. 61-62)

e. The Trust Had No Books of Its Own.

The income and expenses of this trust were shown on the regular ledger sheets of the trust company, exactly like those used for all trust estates administered by the company. (R. 54-55) An examination of the ledger sheets which were offered in evidence (R. 131-141) will show the items of income and disbursement; the rent payments received; the payment of mortgage interest and amortization; the semiannual payment of the trustee's compensation; and the quarterly distribution among the beneficiaries of the balance available for them. The trust had no balance sheet (R. 54-59), and the reports made to the beneficiaries were quarterly statements of income and expenditures such as are made by all trust companies to beneficiaries of trust estates. (R. 54)

f. The Trust Involved No "Management" in any Proper Sense.

It is quite clear from the testimony that no "management" of any kind was involved in the present case, except such as is necessarily involved in the administration of any trust property. The sole asset of the trust was a single piece of property, long since leased to a

tenant under a long term net lease. Neither the trustee nor the beneficiaries had any part in the management of the building which the tenant had erected on this and the adjoining land, or in the department store which the tenant operated in the building. (R. 53) The trustee did not inspect the property to see if repairs were necessary (R. 53) ; it had no responsibility for insurance upon the premises (R. 53, 62) ; it had no responsibility for the payment of taxes, water rent, etc. (R. 53, 62)

It is true that, after the lessee defaulted and went into bankruptcy in 1932, it became necessary to negotiate a new lease; and this was done by a committee of two persons, one of whom was an officer of the trust company, acting on behalf of all of the property owners in the block covered by the department store. (R. 62-63) As a consequence, an agreement was entered into by all the property owners with the reorganized tenant, the effect of which was to reduce the rental stipulated in the lease. (R. 67) For the services of its officer in this connection, the trust company received a separate compensation from the Marshall heirs. (R. 63) While the court below appears to attach importance to this fact and seems to believe that this is something outside the ordinary and usual kind of trust administration, it is difficult to see how this is anything other than a necessary endeavor to protect and conserve the trust estate. It can hardly be regarded as engaging in the "conduct of a business," as the majority of the lower court appeared to think.

This is clearly not a case in which there was anything which might be described as the "creation of income through the enterprise and activities of the trustee."

g. The Trust Was Not Used As a Device For Financing an Enterprise.

In virtually every other case in which trusts have been held to be taxable as "associations," an examination of the facts will reveal that the trust device was used to facilitate the financing of a new business venture or undertaking. The trust device was used to permit the sale of beneficial interests just as certificates of stock in a corporation are sold. Nothing of that kind exists in the present case. The beneficiaries furthermore gave no thought to the question of guarding against personal liability of the beneficiaries. (R. 49)

h. The Additional Powers of the Trustee Do Not Alter the Nature of the Trust.

It is true that under the terms of the deed of trust, the trustee was given power, with the approval of a majority in interest of the beneficiaries, to borrow money to pay for the construction of a building on the premises or to sell the whole or part of the property. While the bare existence of these powers (though they were never exercised) led the majority of the court below to conclude that the trust is not to be regarded as a strict trust, that view seems wholly refuted by the following statement in the dissenting opinion:

"* * * In the light of the fact that the trust estate consisted of a single tract of land entirely occupied by an existing business building leased to a single department store, the powers of the trustee to borrow money to construct a building on the land and to sell the whole or any part of the trust estate lose their significance." (R. 151)

2. The Decision of the Court Below Conflicts With Decisions of the Circuit Courts of Appeals for the First and Seventh Circuits.

The decision of the court below conflicts with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Myers v. Commissioner*, 89 F. (2d) 86 (C. C. A. 7, 1937). In that case three brothers had an undivided interest in certain real estate on which was erected a store building, the principal tenant of which was a corporation, of which the brothers were the sole shareholders, which conducted a clothing business. The old building burned down, and the brothers built a larger new one, the construction of which they financed in part by means of a mortgage loan. Thereupon they conveyed their interest in the land to themselves as trustees under a deed of trust which extended for a period slightly longer than the term of the mortgage on the property. The deed of trust provided for succession of trustees, assignable interest of beneficiaries, compensation of the trustees, etc. The Court, distinguishing the *Morrissey* case, and reversing the Board of Tax Appeals, held that:

"It is thus seen that the trust in question was brought into being in relationship to a particular piece of property owned by three brothers as cotenants for many years. They had reached a period in their affairs when it was desired to replace the former improvements with a modern building. Their chief tenant of both the old and the new building was Myers Bros., the corporation, their own enterprise. * * * Motivated by a desire to protect their investment and to maintain the same intact during the time deemed necessary to liquidate the mortgage indebtedness, without the property being subject to the usual hazard of death and succession, they created the trust. * * *

"We think it reasonably clear on the facts stated that the purpose of this trust was not the operation of a business enterprise. The only business transacted by the trust was the keeping of the building in a tenantable condition and the collection of rents for the use of the owners of the beneficial interests. Instead of concluding that the trust was formed for a business purpose, rather do we think it fair to say that such business as it transacted was merely incidental to the broader purpose of preservation. The inception of the trust had no relation to the transaction of any business. The construction of the building had many months before been determined upon and was well on its way to completion when the trust was formed. Every trust of the purest type necessarily has attributes of a business organization. Its very existence depends on such. That characteristic alone cannot brand it as an 'association.' If the father of the three Myers brothers had by his will set up a trust estate for their benefit in the precise manner here indicated, it would have been almost typical of the traditional type of family trust. We think it none the less so that its creation has been by the three brothers."⁸

The foregoing language could, with hardly any change, be applicable to facts of the case at bar.

An earlier decision of the same court with which the decision in the case at bar conflicts is *Tyson v. Commissioner*, 54 F. (2d) 29 (C. C. A. 7, 1931).

The decision of the court below also conflicts directly with that of the Circuit Court of Appeals for the First Circuit in *Lansdowne Realty Trust v. Commis-*

⁸ 89 F. (2d) at p. 89.

sioner, 50 F. (2d) 56 (C. C. A. 1, 1931). That case involved a trust of real property upon which was erected a building leased under a "net lease" to two tenants. The powers of the trustee were almost identical with those of the trustee in the case at bar. In that case the Court said:

"* * * It is true that the trustees had powers of a broad character, but they did not exercise them and were not carrying on business after the form and manner of a corporation. When the trustees received the property, it had all been leased for a term of five years from March 1, 1920. During this period of five years the trustees were not called upon to seek tenants or to do anything with reference to the property of any consequence except to collect the rents and turn them over to the beneficiaries. By the terms of the lease the lessees were to keep the premises in repair, pay the insurance, and be responsible for all damages connected with the building. It is perfectly apparent that they were not doing business in any sense, during the years 1923 and 1924, and we are of the opinion that, during the years 1925 and 1926, they were not conducting business after the mode and manner of a corporation, but were doing nothing more than trustees ordinarily would be called upon to perform in the management of trust property. * * *"⁹

Respectfully submitted,

CHARLES DENBY,
Attorney for Petitioner.

⁹ 50 F. (2d) at p. 58.



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(I)

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 110

LEE H. MARSHALL HEIRS ET AL., FIDELITY TRUST
COMPANY, TRUSTEE, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE THIRD
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The majority and dissenting opinions in the Board of Tax Appeals (R. 15-32) are reported at 39 B. T. A. 101. The majority and dissenting opinions in the Circuit Court of Appeals (R. 145-152) are not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 26, 1940. (R. 152.) The

petition for a writ of certiorari was filed May 28, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the trust of which the petitioner is the trustee was an association taxable as a corporation under Section 801 (a) (2) of the Revenue Act of 1934.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 12-16.

STATEMENT

The facts found by the Board of Tax Appeals (R. 16-25), from a stipulation (R. 40-47), testimony (R. 47-65), and exhibits (R. 67-141), may be summarized as follows:

The petitioner (formerly Fidelity Title & Trust Company) during the taxable year was trustee under an instrument (R. 81-89) made November 30, 1925, whereby the four children of George V. and Emma L. Marshall, and their respective spouses, conveyed to the petitioner a certain tract of land known as the "Marshall land" in trust for themselves, the trust to continue during the life of the longest living of the eight beneficiaries, but in no event beyond April 30, 1968. (R. 16-17.)

The Marshall land, which was the only asset of the trust, was part of a larger tract on which was

constructed the Frank & Seder Department Store building, in the City of Pittsburgh. The building stood on several tracts of land, all under leases running to April 30, 1968, under all of which the lessee was to pay, in addition to rental, the taxes and water rent, gas, electricity, insurance, and was to make all repairs and remove debris. (R. 19.)

The instrument by which the Marshall land was conveyed in trust to the petitioner gave the trustee the power to hold, manage and control the property; to lease it in whole or in part with the consent of the majority of the beneficiaries, or, if a majority of the beneficiaries could not agree, then according to its own judgment for a term not exceeding three years; to collect, receive, sue for and recover the rents, issues, and profits therefrom; to oversee the payment of taxes, municipal assessments, insurance and interest on mortgages; to make payments on the principal of any mortgage, as agreed to by a majority of the beneficiaries; to contract for the repair and general upkeep of the property; to pay all charges and expenses in connection with the property, and thereafter to pay the net income from the property to the beneficiaries, their heirs, executors, and assigns, as their interest may appear; to sell at public or private sale the whole or any part of the property, and give deeds therefor, with the consent of a majority of the beneficiaries; and to borrow money and execute bonds and mortgages therefor for the payment of any lien or for other purposes, including the construction of a building

on the premises or for alterations or improvements thereto, with the approval of a majority of the beneficiaries. The trustee was not to be liable beyond the property in its hands for judgment, taxes, or any other charges. The trust was subject to revocation at any time¹ by a majority in interest of the beneficiaries, their heirs and assigns. (R. 16-19.)

The four Marshall children had received the Marshall land on November 30, 1925, by a conveyance to them as tenants in common, from the Marshall Land Company, a corporation, of which they had been the sole stockholders since February 28, 1922, when their mother, Emma L. Marshall, had transferred to them all of the stock of that corporation. The mother had formed that corporation in September, 1920, and conveyed to it the interest in the Marshall land which she had acquired upon the death of her husband, George V. Marshall, on May 6, 1918, and the corporation subsequently acquired other outstanding interests in the land. (R. 21-23.)

A lease of his interest in the Marshall land to Frank & Seder, under which a new building was to be erected by the lessee, had been made by George V. Marshall on May 22, 1917, for a period ending April 30, 1938. On April 24, 1924, the Marshall Land Company made a lease to National Depart-

¹ The trust was revoked and terminated on August 7, 1936, after the Government had claimed that it was taxable as a corporation. (R. 51.)

ment Stores, Inc. (successor to Frank & Seder), for an additional thirty years running to April 30, 1968, for a fixed net rental, all taxes, insurance, and repairs to be paid by the lessee. After this new lease was made, the four Marshall children, who were then the stockholders of the Marshall Land Company, determined to dissolve the corporation and convey the property to a trustee, which they did, after the conveyance of the property from the corporation to them, on November 30, 1925. (R. 20-21, 22-23.)

When the Marshall land was conveyed to the petitioner as trustee, it was subject, in addition to the lease, to a mortgage which became due in 1927, at which time the balance then due was paid off from the proceeds of a new mortgage made in 1927, under which payments for interest and amortization of principal were to be made for fourteen years, and the balance to be paid at the end of the fifteenth year. (R. 23.)

For the purpose of either renting or selling, the Marshall land was more valuable as a unit than if the heirs had endeavored to rent or sell their separate shares. None of the trust beneficiaries was qualified to manage the property for rental purposes; they had no such business experience. The beneficiaries held meetings or conferences from time to time for the purpose of discussing matters relative to the trust. (R. 24.)

The tenant of the Marshall land defaulted in the payment of rent in 1932, and the petitioner, instead

of exercising its option to eject the tenant, entered into negotiations which continued for about three and a half years and which culminated in a new agreement made in November, 1935, under which the leasing was to be continued, under modified rentals, to a new corporation to be formed in a reorganization proceeding of the tenant. (R. 24-25.)

On March 15, 1935, the petitioner filed a fiduciary return of income for the year 1934, showing a net income of \$9,698.86 and the distribution thereof equally to the four beneficiaries, who reported their distributive share in their individual income tax returns for 1934 and paid the tax due thereon. (R. 24.)

The Commissioner of Internal Revenue, holding that the petitioner was an association taxable as a corporation, determined a deficiency in income and excess profits tax against the petitioner on that basis for the year 1934,² in the respective amounts of \$1,333.59 and \$484.94. (R. 9-13.)

The Commissioner's determination was sustained by the Board of Tax Appeals (R. 25-30), and the decision of the Board was affirmed by the court below (R. 145-150).

² The determination of similar deficiencies for the years 1932 and 1933 was upset by the court below, on the authority of the decision of this Court in *Germantown Trust Co. v. Commissioner*, decided February 26, 1940, on the ground that they were barred by limitations.

ARGUMENT

There are no conflicts and the decision below is in accord with established principles.

The court below, affirming the Board and the Commissioner, correctly concluded that the trust here involved was an association taxable as a corporation under the statute (Section 801 (a) (2) of the Revenue Act of 1934, *infra*) and the Regulations (Articles 801-1, 801-2, and 801-3 of Treasury Regulations 86, *infra*).³ *Morrissey v. Commissioner*, 296 U. S. 344; *Helvering v. Coleman-Gilbert*, 296 U. S. 369; *Swanson v. Commissioner*, 296 U. S. 362; *Helvering v. Combs*, 296 U. S. 365. The four Marshall children, who were the owners of the property as tenants in common, associated themselves in a joint enterprise for the transaction of business and division of gains, exactly as had been done theretofore by the corporation, the Marshall Land Company, of which they were the sole shareholders. (R. 21-22, 44, 48, 50, 65.) By the transfer to the trust they secured continuing and uninterrupted centralized management—subject to revocation—until the death of the longest living beneficiary, but not beyond April 30, 1968. The con-

³ As the court below observed (R. 150), these Regulations, though considerably expanded, are not dissimilar to those promulgated under the Revenue Act of 1924 (Articles 1502 and 1504 of Treasury Regulations 65, as amended), which Congress, in subsequently using the term "association" in the 1924 Act, must be presumed to have viewed with approval. *Morrissey v. Commissioner*, 296 U. S. 344, 355.

tinuity was not to be interrupted by the death of any of the beneficial owners nor by the transfer of any beneficial interest. The trustee was vested with broad powers, essential to the carrying on of business for profit. (R. 28, 149.) The main purpose of the trust, as shown by the instrument, was neither liquidation nor holding and preserving the property (R. 27), but the carrying on of a business for profit and the sharing of gains. Clearly, under the facts, this is a case where those beneficially interested "seek to share the advantages of a union of their interests in the common enterprise." *Morrissey v. Commissioner, supra*, p. 357.

The fact that the tenant paid the taxes, insurance, and cost of repairs, allegedly leaving to the trustee little to do during the taxable year except to collect the rent and distribute it, is not, as asserted (Br. 17-19), decisive. As properly pointed out both by the Board and the court below (R. 28, 148), the powers conferred on the trustee in the instrument, rather than the activities engaged in during the particular year, are controlling—otherwise, the same organization might be classed as a trust in one year and as an association in another year. *Morrissey v. Commissioner, supra*, p. 361; *Sloan v. Commissioner*, 63 F. (2d) 666, 669 (C. C. A. 9th); *Commissioner v. Vandergrift R. & Inv. Co.*, 82 F. (2d) 387, 390 (C. C. A. 9th). Moreover, it may be pointed out that the trustee's "handling a large property * * * and seeing that the

lessees lived up to their contracts" was "doing business." *Von Baumbach v. Sargent Land Co.*, 242 U. S. 503, 517.

Neither the limited number of beneficiaries nor the fact that the operations did not extend beyond the one piece of property compels, as suggested (Br. 15, 16), a different conclusion. *Swanson v. Commissioner*, *supra*, p. 365; *Helvering v. Coleman-Gilbert*, *supra*, pp. 372, 373; *Helvering v. Combs*, *supra*, p. 368. That the trust was of a limited duration is not, as implied (Br. 15-16), material. A corporation, too, could be made of limited duration. Nor is the absence of particular formalities of procedure or records significant, as argued (Br. 16-17). *Helvering v. Coleman-Gilbert*, *supra*, p. 373. and *Helvering v. Combs*, *supra*, p. 369.

The decision of the court below is a correct application of the principles enunciated by this Court to the facts of the instant case, and is in accord rather than in conflict with the *Morrissey* case. Nor is it in conflict with *Lewis & Co. v. Commissioner*, 301 U. S. 385. The different result in the *Lewis* case is accounted for by the facts there involved, which distinguish it from the instant case. There were no "associates" in that case, for the two beneficiaries consisted of the single grantor and owner of the property and one who was a mere agent of the grantor and whose rights were limited to commissions on sales. Moreover, the powers and duties of the trustee there were purely ministerial.

Nor is there any conflict, as urged (Pet. 6), with *Lansdowne Realty Trust v. Commissioner*, 50 F. (2d) 56 (C. C. A. 1st), or *Myers v. Commissioner*, 89 F. (2d) 86 (C. C. A. 7th). The purpose of the trust in the *Lansdowne* case was primarily to liquidate, the trustees being obliged to convert the property into cash and distribute it, with the right to defer the conversion for a period not to exceed twenty years. The statement made by the court there to the effect that although the trustees had broad powers they did not exercise them and hence the trust was not an association carrying on business, must be viewed in the light of the fact that the case was decided in 1931, at least several years before this Court had held in the *Morrissey* case that the purposes and powers of a trust, whether exercised or not, are determinative. *Tyson v. Commissioner*, 54 F. (2d) 29 (C. C. A. 7th), with which conflict is also claimed (Br. 21) is similarly distinguishable. The *Myers* case is likewise distinguishable on the facts because it involved a trust formed by three brothers in order "to make more certain their ability to hold the property together until the liquidation of the mortgage". (89 F. (2d), p. 87.) That case turned upon its own peculiar facts, which the court recognized distinguished it from the *Morrissey* and companion cases decided by this Court (89 F. (2d), pp. 89-90), and which, we submit, distinguish it from the instant case.

CONCLUSION

The decision of the court below correctly applies the statute and the governing principles established by decisions of this Court, to the facts of the case. There is no conflict of decisions. The petition should, therefore, be denied.

Respectfully submitted.

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JUNE, 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680, 771:

SEC. 801. DEFINITIONS.

(a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

* * * *

(U. S. C., Title 26, Sec. 1696.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 801-1. *Classification of taxables.*—For the purpose of taxation the Act makes its own classifications and prescribes its own standards of classification. Local law is of no importance in this connection. Thus a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. * * * The definitions, terms, and classifications, as set forth in section 801, shall have the same respective meaning and scope in these regulations.

ART. 801-2. *Association.*—The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of

which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Act, a trust or an estate, or a partnership. * * *

ART. 801-3. *Association distinguished from trust.*—The term "trust," as used in the Act, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agree-

ment of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Act as a corporation.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust

form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Act disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the

activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

* * * * *

